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SUBJECT: KUWAIT BANKING AND FINANCE UPDATE, SEPTEMBER 2004

(U) This cable is sensitive but unclassified; please protect accordingly.

11. (SBU) Summary: In this edition of the Kuwait Banking & Finance Update: the Central Bank raises interest rates; a Kuwaiti bank limits its business in Iraq due to security concerns; the banking sector opens to foreign banks; a new Islamic bank is formed; and a new draft tax law is approved by the Council of Ministers and referred to the National Assembly. End Summary.

Interest Rate Hike: Cooling down an overheated economy

12. (U) In what some news reports called a "surprise move," the Central Bank of Kuwait (CBK) raised the discount interest rate on 3 August from 3.5% to 4%. After initial grumbling in the press and among some National Assembly (NA) members about the timing and surprise nature of the announcement, most financial analysts and members of the banking community agreed that the rate hike was called for. In an August 19 meeting with EconOff, National Bank of Kuwait (NBK) General Manager for Asset Management and Treasury George Nasra said that the recent rate hike was "necessary and understandable," and was "needed to cool down the real estate sector and stock market." Nasra did not foresee the CBK moving away from keeping interest rate fluctuations in line with US Federal Reserve interest rate changes. In an August 29 courtesy call by CDA, Central Bank Governor Sheikh Salem Abdul Aziz Al-Sabah echoed Nasra's opinion, saying that the Kuwait economy has become "over-enthusiastic." He added that there had been "too much expectation of an Iraq reconstruction boom," and that the interest rate was raised to cool down some of the excess borrowing.

NBK in Iraq: Eager for business, wary of security

13. (SBU) In an August 19 meeting, NBK GM Nasra told EconOff that NBK has acquired about 15 branches of a local Iraqi bank, with plans to focus on Baghdad and Basra. It will operate the banks using mostly local employees, with some management personnel sent from Kuwait. While the original plan was to begin operations in January 2005, per the January 2004 agreement between the Central Bank of Iraq (CBI) and NBK, the current security situation was casting that timeframe into doubt. Nasra said that everything depended on the security situation, adding that the opening of its banking operations "depends on what happens today in Najaf." (Comment: By this, Nasra meant that everything depended on the security situation in all of Iraq, and not just in the cities or neighborhoods where NBK planned to operate branches. End Comment.)

14. (SBU) In an August 24 courtesy call by CDA, NBK CEO Ibrahim Dabdoub expanded further on NBK's business in Iraq. He explained that NBK has actually purchased an 85% share of a bank chain owned by the Kubba family in Iraq, but that NBK would keep the family name on the bank for the next year or two. NBK currently has 15 people from the bank in Kuwait for training. While noting that "the business potential in Iraq is huge," Dabdoub said that NBK will likely ask the CBI for an extension on the deadline to be operational, in order to "let the security situation settle down."

15. (U) NBK is also facilitating wire transfers with two or three banks in Iraq, according to NBK GM Nasra, but the demand is very low. He is seeing some demand for global payments made from Baghdad, but not much the other way, into Iraq. Nasra said that the Iraq Trade Bank, operated as a consortium, was working out well so far, and he had no specific difficulties to report.

First Foreign Bank Licensed in Kuwait

16. (U) Following on the January 2004 approval by the National Assembly to allow foreign banks to enter the Kuwaiti market, the CBK granted BNP Paribas the first license for a foreign bank in the country in August 2004. The license must

go for approval by the Cabinet of Ministers before it becomes law. Citigroup, Standard Chartered Bank and HSBC are also reported to have applied for licenses.

17. (SBU) NBK GM Nasra said that BNP Paribas would start operating once it has been given GOK approval, and that other foreign banks were on the way. He saw these new market entrants as possibly affecting smaller, weaker banks, but not NBK. He did expect that the foreign banks would eat into some of NBK's market share in the areas of wealth management, credit card services, and other advisory services, but did not expect NBK to be challenged in retail banking. Nasra said that a Citibank colleague based in Bahrain told him that the holdup of Citibank's entrance into the Kuwait market was the fault of Citibank, and not the GOK. CBK Governor Sheikh Salem, in the August 29 courtesy call, said that Citibank needed to submit more paperwork to meet certain requirements but that Citibank was definitely interested in doing business in Kuwait. Sheikh Salem echoed Nasra's opinion, saying that the presence of foreign banks would increase competition in the areas of corporate banking, portfolio management and wealth management.

Islamic Banking: A New Bank and a Growing Market

18. (U) The Bubiyan Islamic Bank, a new Islamic bank established by the Kuwait Investment Authority (KIA), is still in the process of being formed after its May 2004 initial public offering. On August 21, the CBK announced a proposed list of 15 board members, but there has been some dispute over the position of the bank chairman. Local newspapers reported on August 22 that an Islamic party is supporting a candidate for chairmanship of Bubiyan Bank who is not on CBK's proposed list of board members.

19. (U) NBK GM Nasra said that NBK currently offers some Islamic financial services, including leasing, and money market and real estate funds, but was not yet offering retail Islamic banking services. In Kuwait, he noted, Islamic banking and conventional banking are separated by law, so it is easier for an institution to operate solely one way or the other. He expected some competition from Bubiyan Islamic Bank and from other local banks. Nasra said that he sees a growing demand for such services, both in Kuwait and in the region.

Draft Tax Law Referred to National Assembly

10. (U) A draft tax law has been approved by the Council of Ministers on August 25, and will be sent to the National Assembly in the fall 2004 session. The draft law calls for a progressive tax on net income and excludes salaries and certain low-income wage earners. The draft law exempts the Amir and Crown Prince from paying the taxes, which will be collected on January 1 of each year. The proposed law calls for the following taxes on "net income from commercial, industrial, private, capital or real estate activities:"

KD 1 to KD 10,000	2.5%
KD 10,000 to KD 50,000	5.0%
KD 50,000 to KD 250,000	10.0%
KD 250,000 to KD 1 million	15.0%
KD 1 million to KD 5 million	20.0%
KD 5 million and higher	25.0%

11. (U) Post will provide additional financial news in regular update cables.
TUELLER